Stability vs. Flexibility: Can the European Union find the Balance?

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To what extent can a State forego its contractual commitments, in particular those arising from a stabilization clause for human rights and environmental protection? ("under a stabilization clause, the host State commits itself either not to enact changes of the domestic law in the future, or at least, not to apply such changes to the investor", Ohler, *Concessions*, Max Planck Encyclopedia, 2009.) Our assumption is that stabilization clauses and states' rights to regulate should be integrated and not be taken as opposite obligations, considered as incompatible. In other words, if framed correctly, stabilization clauses can balance the two conflicting needs at stake: the sanctity of contract and a state's right to regulate to protect its public interest (Leben, *L'évolution de la Notion de Contrat d'État*, Revue de l'arbitrage, 2003; Carbone, Luzzatto, *Il Contratto internazionale*, 1996; Giardina, *State Contracts, national versus international law,* The Italian Yearbook of international law, 1980; Fatours, *International Law and International Contract,* 1980; Mann, *State Contracts in International Arbitration*, 1967).

This post examines whether the (fairly) new European exclusive competence on foreign direct investment changes the way stabilization clauses should be framed in EU State contracts to avoid potential conflicts. There are two different kinds of possible conflicts that could arise: first involving either provisions among themselves, or second, the two different legal regimes at stake (the international and the European).

With respect to conflicts between European law and a State-contract provisions: a rigid stabilization clause compels a member State to pay compensation, if requested to align its national law to new European rules, which negatively impact foreign investment. Vice versa when, in order to respect the stabilization clause, the same State fails to comply with the new European provision, it may face infringement proceedings. In both scenarios a stabilization clause, framed in a rigid way, will force a member State to decide whether to respect a State-contract provision (such as the stabilization clause), or a European one. As a question of principle, the State involved should let European law prevail as a source of law higher than the one included in a State contract (whether international, transnational or national).

For example, one can look at the potential conflict between stabilization clauses and the recently enacted European public procurement directives (EU Directive n. 2014/24/EU; EU Directive 2014/25/EU; EU Directive 2014/23/UE). These directives allow the inclusion in public contracts of a sort of equilibrium clause (EU Directive 23/2014, premise n. 87 and

art. 43); they also expressly provide the external factual conditions which allow the re-balancing of contractual obligations (EU Directive 24/2014, premise n. 11). Lastly, they envisage the reason which legitimize contract termination (see art. 72, directive 24/2014). Except when expressly provided for by the normative provision, the State party should not be precluded to enact new legislation in respect of fundamental rights.

The provisions included in the public-procurement directives render all rigid stabilization clauses (such as those framed as freezing clauses), inconsistent with European law. Accordingly, if they are included in a State-contract they should be deemed inapplicable as a matter of European law prevailing over a member State's law on questions of principle (*primauté*). Any national law would have to be consistent with those that introduce a European provision in the domestic legal order (i.e. Italy in 2015 enacted a new Code of public procurement contracts fully consistent with EU directives).

The second kind of conflict might arise between the latest fair and equitable treatment clauses (FET) in European agreements (CETA art. 8.10) and stabilization clauses. The FET clause included in new European agreements (such as CETA) is well defined, reducing the risk of the foreign State breaching the agreements for enacting legislation aimed at protecting its public order. Therefore, if a contract signed by a member State includes a rigid stabilization clause, the risk of inconsistency between this latter and the FET clause is substantial.

This might lead to conflicts between systems: the international and the European. In practical terms, a foreign investor could initiate arbitral proceedings for breach of a BIT's fair and equitable clause, arguing that the measure enacted by the member State impairs its investment (protected by the BIT). In parallel, the same measure could entail a breach of contract, as it violates the stabilization clause included therein. In case the two above mentioned disputes arise in front of two different *fora*, the very same measure could be considered in line with the FET clause and in breach of the stabilization clause, or vice versa. This inconsistency will ultimately affect recognition and enforcement phases of any decision over the dispute. Should a host State, for example, pay for compensation in case the measure appears consistent with the FET clause in the arbitral proceeding, but is simultaneously found to violate the stabilization clause in the domestic proceeding? In the given scenario, if the State pays, it abides by the domestic decision but acts inconsistently with the international decision.

Clearly, stabilization clauses in future public procurement contracts should be framed consistently with the relevant European provisions and in line with the fair and equitable clause provided in the European agreements.

If a dispute arises on the alleged violation of a contractual provision, before finding any breach of the source at stake, I suggest that the competent *forum* should adopt the proportionality approach used by the European Court of Justice, which could find a balance between economic and non-economic values (ECJ, decision of 11 May 2000, in C-38/98, *Régie nationale des usines Renault SA v. Mexicar SpA and Orazio Formento*). Similarly, the U.S. Supreme Court in Mitsubishi, "*distinguished between international arbitral awards*

that thwart the fundamental purposes of a norm that is mandatory under domestic law and those that do not, suggesting that the latter, but not the former could be tolerated in the interest of arbitration" (*Mitsubishi Motors Corporations v. Soler Chrysler-Plymouth* , Inc*,* 473, U.S. 614, 1985). In the end, the broadening of European competence in external relation increases the point of contacts among sources of law and different legal systems. The European Union should therefore make every effort to avoid concrete and potential inconsistencies between them (W. Jenks, *The Conflict of Law-Making Treaties*, 1953).